OFFICES OF THE COUNTY EXECUTIVE

Douglas M. Duncan
County Executive

Bruce Romer
Chief Administrative Officer

December 5, 2003

Members of the Montgomery County Council

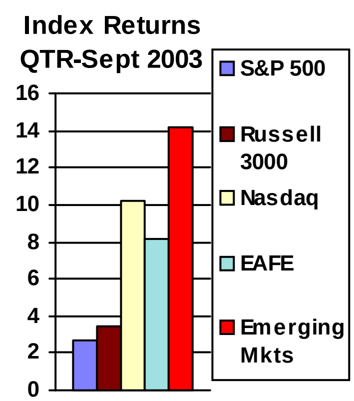
I am pleased to present to you the Quarterly Report of the Montgomery County Employees' Retirement System ("ERS") for the quarter ended September 30, 2003. This quarterly report is designed to assist you in understanding the current status of the ERS. This report was prepared pursuant to the provisions of Section 33-51(a)(4) of the Montgomery County Code of 1994, as amended.

History

The Employees' Retirement System was established in 1965 as a cost-sharing multiple-employer defined benefit pension plan providing benefits to the employees of Montgomery County and other agencies or political subdivisions who elect to participate. In addition to Montgomery County Government, participating agencies and subdivisions include the Montgomery County Revenue Authority, Housing Opportunities Commission of Montgomery County, independent fire/rescue corporations, Town of Chevy Chase, Strathmore Hall Foundation, Inc., Washington Suburban Transit Commission, and certain employees of the State Department of Assessments and Taxation and the District Court of Maryland. The System is closed to employees hired on or after October 1, 1994, except public safety bargaining unit employees. There were 5,876 active members and 4,370 retirees participating in the System as of June 30, 2003.

Capital Markets and Economic Conditions

The U.S. economy strengthened markedly during the quarter with growth at 7.2%. Businesses appear to be somewhat skeptical of the ability to maintain this level of growth as evidenced by continued labor shedding and an apparent unwillingness to build inventories. Capital spending is rising but not by enough to accelerate the pace of capacity accumulation. The Consumer Confidence index fell to 76.8 in September, a six-month low, as the economy's failure to generate job growth raised concerns over the sustainability of further expansion. While improvement in employment data is key to further economic growth, the combination of a weak dollar, equity market strength, and stronger earnings may continue to put pressure on fixed income markets.



Stock markets rose in July and August and declined in September, ending the quarter with positive results (see chart to the right). The primary driver behind the continuing strong advance in stock prices is investors' confidence in the economy and the strong corporate profit picture. Consumers continued their spending spree during the quarter, this time using funds from the tax cut versus mortgage refinancings. However, the dramatic fall off in mortgage refinancings and a still sluggish employment picture point to future problems in the consumer sector. The wealth effect of rising equity prices and home values seems to be offsetting these potential problems.

During the quarter, small company stocks outperformed their larger counterparts while stocks with a growth bias outperformed value stocks. Our combined domestic equity performance was 4.0%, outperforming the benchmark index by over 50 bpts. Internationally, emerging markets had the strongest returns, up 14.2% for the quarter aided in part by the weak dollar. The Pacific markets, especially shares traded in Hong Kong, rebounded strongly due to China's growth prospects and an improved outlook for the global economy. Buying by foreign investors pushed Japanese stocks higher, and U.S. based investors enjoyed significant currency gains when the U.S. dollar slid in value against the yen. Our combined international equity performance was 11.9% for the quarter, well ahead of the benchmark index return of 8.7%.

Within the fixed income markets, the Treasury yield curve steepened slightly during the quarter, in extremely volatile trading. During the first two months, yields rose sharply and virtually without interruption in response to strengthening economic data and a tougher tone from the Fed. In September, yields came down as quickly as they went up as the economic data shifted from uniformly strong to mixed. Corporate bonds had the best results as spreads over Treasuries continued to tighten. The combined return for our fixed income managers was .8%, slightly ahead of the .4% return of the benchmark index.

The total return achieved by the Employees' Retirement System's assets for the quarter was 4.0% compared to the System's benchmark index return of 3.2%. For the one year period ending September 30, the System's total return was 21.2% compared to the benchmark return of 21.0%. The strong one-year return places the System's performance in the top ten percent of a universe of public pension funds constructed by the Board's consultant, Wilshire Associates. The System's outperformance continued through November 30 with the one-year return nearly 200 basis points above the benchmark index. The asset allocation at September 30, 2003 was: Domestic Equities 49.9%, International Equities 16.2%, Fixed Income 28.6%, TIPS 4.7%, Alternative Investments .1%, Cash .1% and Real Estate .4%.

Additions

The primary sources of additions for the ERS include member and employer contributions and investment income. The following tables show the source and amount of additions for the quarter ending September 30, 2003 and fiscal year-to-date.

Employees' Retirement System
Contributions and Investment Income
(millions)

	Qtr 9/30/03	Fiscal YTD
Employer Contributions	$ 15.3	$ 15.3
Member Contributions	3.6	3.6
Net Investment Income	67.6	67.6
	$ 86.5	$ 86.5

Deductions

The deductions from the Employees' Retirement System include the payment of retiree and survivor benefits, participant refunds, administrative expenses and other costs.

Employees' Retirement System Deductions by Type (millions)	**QTR 9/30/03**	**Fiscal YTD**
Benefits	$28.1	$28.1
Refunds	.2	.2
Administrative Expenses	.5	.5
	$28.8	$28.8

Outlook

The strong performance of the economy during the September quarter may have been the result of one time events rather than a signal of strong economic growth momentum. Consumer spending is likely to stall now that summer tax cuts are behind us and mortgage refinancings are slowing. The big question is will the Fed be successful in re-inflating the economy? Economic forecasts see a strong probability of the Fed easing rates by 50 bpts. over the next six months.

Major Initiatives

During the last quarter, the Board completed a review of the international equity allocation and manager structure, resulting in changes to the investment guidelines, increasing the System's allocation to emerging markets and reducing the percentage invested passively in developed countries represented in the EAFE index. In addition, the Board completed a small capitalization value manager search resulting in the selection of Wellington Management in Boston.

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF PLAN NET ASSETS
September 30, 2003

Assets	
Equity in County's pooled cash and investments	$507,438
Investments	
Northern Trust	1,771,683,555
Aetna	8,593,340
Fidelity - Elected Officials Plan	567,280
Fidelity - Deferred Retirement Option Plan	281,968
Total investments	1,781,126,143
Contributions receivable	4,983,840
Fixed assets, at cost:	
Office equipment	111,375
Less: accumulated depreciation	111,375
Net fixed assets	-
Total assets	1,786,617,421
Liabilities	
Benefits payable and other liabilities	2,426,631
Net assets held in trust for pension benefits	**$1,784,190,790**

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF CHANGES IN PLAN NET ASSETS
September 30, 2003

Additions	**Quarter**	**Fiscal YTD**
Contributions		
Employer	$15,269,918	$15,269,918
Members	3,629,469	3,629,469
Total contributions	18,899,387	18,899,387
Investment income	69,195,104	69,195,104
Less investment expenses	1,636,204	1,636,204
Net investment income	67,558,900	67,558,900
Total additions	86,458,287	86,458,287
Deductions		
Retiree benefits	22,157,707	22,157,707
Disability benefits	4,780,000	4,780,000
Survivor benefits	1,222,500	1,222,500
Refunds	159,957	159,957
Administrative expenses	490,611	490,611
Total deductions	28,810,775	28,810,775
Net increase	57,647,512	57,647,512
Net assets held in trust for pension benefits		
Beginning of period	1,726,543,279	1,726,543,279
End of period	**$1,784,190,790**	**$1,784,190,790**